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CITATIONS

CASES:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner,*

v.

TEXACO INC., ET AL., *Respondents.*

72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., *Petitioners,*

v.

TEXACO INC., ET AL., *Respondents.*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA [1]

PRELIMINARY STATEMENT

The Interstate Natural Gas Association of America (INGAA) is a non-profit trade association representing virtually all of the major long-distance natural

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[1] In proceedings at the Commission and in the court below, and in previous pleadings to this Court, the Interstate Natural Gas Association of America was identified by its former name, that is, the Independent Natural Gas Association of America. The change in name became effective as of January 1, 1974.

gas transmission lines (pipelines) in the United States. INGAA, a petitioner in the court below, urges that the judgment of the United States Court of Appeals for the District of Columbia Circuit be affirmed.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 474 F.2d 416. Order No. 428 of the Federal Power Commission (FPC or Commission) (App. 135-154), its amending Order No. 428-A (App. 159-161), and its Order No. 428-B denying rehearing (App. 238-253) are reported at 45 FPC 454, 45 FPC 548, and 46 FPC 47, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on December 12, 1972, and the Commission's petition for rehearing was denied on February 5, 1973. The petition for a writ of certiorari was filed on May 3, 1973, and was granted on October 9, 1973 (App. 254).[2] The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Does the Federal Power Commission have authority to exempt small producers[3] from direct rate regulation

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[2] The Court concurrently granted the petition in *Dougherty, et al.*, No. 72-1491—which sought review of the same judgment of the Court of Appeals—and ordered the cases consolidated for oral argument (App. 254). Reference is made in this brief principally to the petition of the Federal Power Commission, No. 72-1490, inasmuch as *Dougherty, et al.*, do not raise any significant points not already raised by FPC.

[3] "Small producers" are those producers selling annually 10,000,000 Mcf or less of natural gas for resale in interstate commerce.

under the Natural Gas Act (Act) by shifting the burden of establishing the reasonableness of rates for interstate wholesale sales of natural gas from the sellers (small producers) to the purchasers (interstate pipelines or large producers)[4] despite statutory language to the contrary?

STATUTES INVOLVED

Sections 4, 5, 7 and 16 of the Natural Gas Act, 15 U.S.C. 717c, 717d, 717f, and 717o, are set forth in the Appendix to the Commission's brief, pp. 35-43.

STATEMENT OF THE CASE

A. Background

Ever since the landmark decision of this Court in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954), holding that the FPC had jurisdiction under the Natural Gas Act to regulate well-head sales by producers of natural gas to interstate pipelines, efforts have been made to determine appropriate procedures for regulating such sales by the numerous small producers of natural gas. The administrative difficulties in regulating thousands of producers on an individual company basis was one of the principal reasons that prompted the Commission to adopt area rate procedures as the solution for its producer rate problems in the second *Phillips* case, 24 FPC 537 (1960).

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[4] Large producers often purchase gas from small producers and subsequently resell the gas to interstate pipeline purchasers. We recognize that large producers may thus be aggrieved in somewhat the same manner as are the interstate pipelines by Order Nos. 428 and 428-B, but in this brief, INGAA will restrict its discussion to the impact of the Commission's unlawful action upon its pipeline company members.

The Commission's determination to depart from its practice of individual producer rate cases was affirmed by this Court in *Wisconsin* v. *Federal Power Commission,* 373 U.S. 294 (1963). In the first of its series of area rate proceedings, *Permian Basin Area Rate Proceeding,* 34 FPC 159 (1965), the Commission also determined that special administrative treatment for small producers would be appropriate to ease the burden of regulation, 34 FPC at 234-235. At the same time, however, it concluded that outright exemption of small producers, assuming that such was legally permissible, was not "necessary or desirable" (*ibid*). While it, therefore, made the area "just and reasonable" rates applicable to all producers, small and large, the Commission initiated action to relieve small producers of virtually all of the administrative burdens and costs of both the rate and certificate provisions of the Natural Gas Act. This action was embodied in Order No. 308, 34 FPC 1202 (1965) and took the form of the establishment of "Small Producer Certificates" available to any producer with jurisdictional sales of less than 10,000,000 Mcf of gas per year. Under such a certificate, the small producer could undertake all of his existing sales, and any new ones, so long as he did not exceed the annual volume limitation and the applicable "just and reasonable" price ceilings for the particular area.

In its decision affirming the Commission's *Permian Basin* opinions, this Court also expressly affirmed the special administrative treatment afforded to small producers, finding that a proper factual basis existed for such treatment, and that such action was "fully consistent with the terms of [the Commission's] statutory responsibilities." *Permian Basin Area Rate Cases,* 390

U.S. 747, 787 (1968). The Court's opinion, however, does not hold that the Commission's power to so classify small producers for special regulatory treatment pursuant to Section 16 of the Act, also authorized it to exempt them from all direct rate regulation by shifting the burden of establishing the justness and reasonableness of rates for interstate wholesale sales of natural gas from the sellers (small producers) to the purchasers (interstate pipelines or large producers).

B. The Present Proceedings Before The Commission

On July 23, 1970, the Federal Power Commission issued, in Docket No. R-393, a Notice of Proposed Rulemaking entitled "Exemption of Small Producers from Regulation" (App. 1-13). In essence, the Commission proposed to exempt small producers from rate regulation under the Natural Gas Act, permitting them to collect and keep any contractually negotiated prices for gas sold in interstate commerce for resale. The Commission undertook in the Notice to assure small producers that their contract price would not be subject either to refund or prospective change by the FPC. The stated purpose for this proposed action was to stimulate additional exploratory efforts and dedication of gas reserves to the interstate market in order to augment the dwindling supplies. The Commission's principal asserted authority for its proposed rule was its classification powers under Section 16 of the Act.

The Commission did not propose to free small producers from all regulation under the Act, however, announcing that, among other things, it would retain abandonment authority over small producers' sales pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b), as well as requiring certain annual reports. Further,

the Commission proposed to allow pipelines to file "tracking" rate increases [5] to recover increases in their purchased gas costs which were anticipated as a result of exempting small producers from rate regulation.

After receiving comments from various parties, the Commission issued Order No. 428, entitled "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Repirements" (App. 135-154). The Order, in general, followed the proposal indicated by the Commission's Notice of July 23, 1970, with respect to exempting small producers from rate regulation. However, for the first time, the Commission indicated that the pipelines' right to "track" increases in purchased gas costs would be limited to that portion of the contract prices paid to small producers which the Commission, in later proceedings, finds justifiable, i.e., not "unreasonably high." The essence of the newly announced "indirect" scheme is set forth in the following excerpts:

> "The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales *but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers' sales.*" (Emphasis supplied.) (App. 138).
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> "Any question as to the propriety of the price paid by a pipeline to a small producer *will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified.* The

[5] "Tracking" rate increases authorized by the FPC are similar, in concept and effect, to the more familiar "fuel adjustment" clauses.

Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent." (Emphasis supplied.) (App. 139).

* * *

"*Small producers will have no refund obligations* with respect to increased rates * * * However, the *pipeline's rates will be subject to reduction and refund,* with respect to new small producer sales, but only *as to that part of the rate which is unreasonably high* considering appropriate comparisons with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." (Emphasis supplied.) (App. 142).

INGAA and its pipeline members were, theretofore, unaware that the Commission's proposal for deregulation of small producers raised a substantial issue with respect to the pipelines' ability to recover their legitimate expense items of purchased gas, contracted for in good faith efforts to render adequate service to their customers. INGAA, as did certain of its pipeline members, petitioned for rehearing of Order No. 428 and urged the Commission to correct this situation. On July 15, 1971, the Commission issued Order No. 428-B (App. 238-253), which modified Order No. 428 in certain respects not at issue herein but reasserted the Commission's authority to engage in the unprecedented scheme of so-called "indirect" small producer rate regulation at the pipeline level.

C. The Decision Below

The Court of Appeals, with one judge dissenting, set aside the Commission's action exempting small producers from rate regulation after concluding that such

action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).[6]

The lower court's decision turned upon an analysis of specific provisions of the Natural Gas Act, namely, Sections 4, 5, 7 and 16 (FPC Pet., pp. 85a-93a). The court concluded, in effect, that the regulation of rates for jurisdictional sales was *mandatory,* and not discretionary or permissive, regardless of the size of the regulated entity. In that connection, the court held that the Commission's Section 16 classification powers do not permit the exemption of small producers from rate regulation under Section 4 of the Act (FPC Pet., pp. 7a-10a). That being the case, the court held that the Commission's Order Nos. 428 and 428-B represented a clear-cut abdication of statutory duty to assure that *all* regulated rates, including those of small producers, be "just and reasonable" (FPC Pet., pp. 10a-16a). This departure from statutory duty and standards through the so-called "indirect" mode of regulation at the pipeline level contravened the provisions of the Natural Gas Act:

> "Nothing at all insures that those levels [of rates allowed to be passed on to consumers] will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a-13a).

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[6] Reference is to FPC's Petition for Certiorari, No. 72-1490.

Even the dissenting Judge (Fahy) would not have approved the Commission's "indirect" mode of regulating pipelines. In his dissent, Judge Fahy stated that he would have modified the Commission's proposal so as to permit refunds from the small producers to the pipelines and large producers should the Commission find it necessary to protect the purchasers from unreasonably high prices:

> "I would strike its [Order No. 428's] provisions prohibiting refunds to pipelines and producers, leaving open to the Commission to exercise such authority as it has to protect large producers and pipelines. . . ." (FPC Pet., p. 22a).

INGAA's INTEREST IN THE PROCEEDING

As noted hereinabove, INGAA is a non-profit trade association representing virtually all of the major long-distance natural gas transmission lines (pipelines) in the United States which are subject to the jurisdiction of the Commission under the Natural Gas Act. Most, if not all, of these companies are affected by the Commission's Order Nos. 428 and 428-B here under review and are particularly aggrieved by the Commission's action which purports to shift to the pipeline companies the burden of justifying the prices paid for gas purchased from small producers.

INGAA is keenly aware of, and equally sympathetic to, the Commission's stated objective (App. 137) in this proceeding of assuring the maintenance of adequate gas supplies for the interstate market. In that regard, the shortage of natural gas has been judicially recognized by this Court,[7] and needs no further dis-

[7] *Federal Power Commission* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 626 (1972).

cussion. In view of the growing national gas shortage, INGAA's membership views the Commission's aim of stimulating additional exploration and development of gas reserves for the interstate market as a laudable one. Indeed, we are not aware of anyone who would quarrel with such an objective. Such an objective, however, in no way justifies the Commission's action of exempting small producers from rate regulation under the Act and unlawfully placing pipeline companies at their peril in purchasing gas from small producers. Unless this aspect is eliminated, the Commission's action may well be counter-productive to the announced purpose of assuring adequate gas supplies to the interstate market.

SUMMARY OF ARGUMENT

It is INGAA's position that the Commission cannot, under the Natural Gas Act, lawfully "regulate" the rates of small producers through the scheme of so-called "indirect" regulation whereby the Commission would force the purchasing pipelines to absorb any portion of the prices paid by pipelines to small producers which the Commission later determined to be "unreasonably high," by eliminating such amounts from the pipelines' costs of service.

INGAA will show that "indirect" small producer rate regulation is not supported by the rate provisions of the Natural Gas Act and, further, that Section 16 classification powers do not give the Commission discretion to regulate in such a novel manner. Moreover, contrary to the Commission's assertions, nothing in this Court's decisions in *Permian, supra,* and *F.P.C.* v. *Hunt,* 376 U.S. 515 (1964), support "indirect" review of small producers' rates. Indeed, this Court has previously rejected the "indirect" approach to producer regulation in its landmark *Phillips* decision, *supra.*

The Commission has imposed a new regulatory burden on the pipelines which goes beyond the general proposition that pipelines must justify the reasonableness of cost of service items. By its orders on review, the Commission has failed in its duty to give meaningful or workable guidance to the pipelines as to the prices which would be allowed in pipelines' costs of service, thereby threatening the financial health of the pipeline companies. This result, we submit, is clearly contrary to the public interest. See *FPC* v. *Memphis Light, Gas & Water Division,* U.S. , 93 S.Ct. 1723 (1973).

Finally, the Commission has other lawful means by which it can further the objective upon which its orders herein are premised (i.e., the dedication of additional gas reserves to the interstate market). Approval of the Commission's action by this Court is, therefore, unnecessary to reach that desired end result.

ARGUMENT

THE COMMISSION'S SCHEME OF SO-CALLED "INDIRECT" REGULATION OF SMALL PRODUCERS' RATES IS UNLAWFUL UNDER THE NATURAL GAS ACT.

The Commission's principal tactic on brief to this Court is to assert that the court below failed to comprehend the effect of the Commission's Order Nos. 428 and 428-B here on review (FPC Brief, pp. 13-20). The Commission attempts to cast its action as procedural rather than substantive in nature, arguing that it is simply adopting a different mode of regulation of small producers' rates which is within its administrative discretion. The crux of this new "indirect" method of regulation is that the Commission will determine in pipeline and large producer rate proceedings whether the small producers' prices are "unreasonably high," a standard which the FPC claims is the "full equivalent

of the statutory 'just and reasonable' standard" (FPC Brief, p. 16). The burden of disallowance of any prices determined *ex post facto* by the Commission to be "unreasonably high" would fall ***not on the sellers*** but on the purchasers (here, pipelines and large producers). Thus, the essence of the Commission's argument is simply that so long as it asserts that the ultimate consumers of natural gas will not pay "unreasonably high" amounts for small producers' gas, then it matters not one whit where and how the burdens of such regulation fall.

Despite the Commission's repeated denials that it is effectively deregulationg small producers' rates, the court below characterized the effect of the Commission's orders as the unlawful *non*regulation of the small producers' rates (FPC Pet., p. 16a).

A. The Provisions Of The Natural Gas Act Do Not Support The Commission's Action.

The Notice of Rulemaking which preceded the promulgation of Order Nos. 428 and 428-B was forthrightly entitled "Exemption of Small Producers from Regulation" (App. 1). The Notice itself nowhere alluded to the scheme of "indirect" regulation which the Commission adopted in Order No. 428 and reasserted in Order No. 428-B. In Order No. 428, the Commission stated:

> "We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no room for administrative judgment and discretion" (App. 136).

The Commission, however, now appears to concede that it is without power to provide an outright exemp-

tion from regulation by stating that it has not asserted any such authority (FPC Brief, p. 18).

1. The Language of the Statute Requires Regulation of all Rates Subject to the Commission's Jurisdiction.

Even though the Commission appears to now have discarded its reliance upon the authority it had earlier cited for exempting small producers' rates from regulation, claiming instead that its so-called "indirect" scheme saves the action from constituting an outright exemption, it is nevertheless appropriate to briefly review the pertinent provisions of the statute in order to eliminate any doubt that the language of the Act is permissive or discretionary, as the Commission had suggested earlier.

Section 4(a) provides:

> "*All* rates and charges made, demanded, or received by any natural gas company . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful." (Emphasis supplied.)

Section 4(b) provides:

> "*No* natural gas company shall with respect to *any* transportation or *sale* of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person . . . or (2) maintain any unreasonable difference in rates, charges . . . between classes of service." (Emphasis supplied.)

Section 4(c) provides that:

> ". . . *every* natural-gas company *shall file* with the Commission . . . *schedules showing all rates* and charges *for any* transportation or *sale* subject to

the jurisdiction of the Commission . . ." (Emphasis supplied.)

Section 5 is likewise clear. It provides that:

"(a) Whenever the Commission, after hearing . . . shall find that *any* rate . . . charged, or collected by *any* natural-gas company . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission *shall determine the just and reasonable rate* . . . to be thereafter observed and in force, and *shall fix the same by order* . . ." (Emphasis supplied.)

It is not surprising, therefore, that the court below found, after reviewing the above provisions, that they are *mandatory* and are applicable to *all* wholesale sales of natural gas in interstate commerce by producers irrespective of their size (FPC Pet., pp. 7a, 8a). In the face of such unequivocal language, it is also understandable that the Commission seeks to both camouflage and justify its action through the device of "indirect" regulation.

2. Section 16 of the Natural Gas Act Does Not Modify or Diminish the Provisions of Sections 4 and 5 of the Act.

The Commission places heavy reliance for its actions herein upon the classification powers of Section 16 of the Act, 15 U.S.C. 717o. However, as the Court of Appeals held, the regulatory mandate of Sections 4 and 5 of the Act is in no way circumscribed or diminished by Section 16 classification powers which are designed for administrative convenience, and *not* as a device for expanding, contracting or otherwise changing the coverage of the Act:

"Thus the Commission's power, under Section 16 of the Natural Gas Act, to 'classify persons and

> matters within its jurisdiction' and to 'prescribe different requirements for different classes' cannot validate this exemption of small producers. The Commission can only classify '[f]or the purposes of its rules and regulations.' It can only prescribe rules and regulations 'to carry out the provisions of this chapter.' Section 16 thus does not give the Commission independent powers. Rather, *it provides for implementation of the core sections of the Act, such as Section 4.*" (FPC Pet., pp. 9a, 10a). (Emphasis supplied.)

The Court of Appeals correctly concluded that only Congress could effectuate the change in the regulatory scheme sought by the Commission:

> "Only Congress can knowingly prescribe nonregulation for small producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* [*Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954)] to be mandatory under the Natural Gas Act for all producers." (FPC Pet., p. 16a; see also, p. 17a, fn. 25.)[8]

In relying on Section 16 for authority to shift the rate regulatory responsibility from small producers to the pipeline purchasers (FPC Brief, pp. 21-23), the Commission cites its need for flexibility "to make pragmatic adjustments which may be called for by particular circumstances." The court below has correctly noted, however, that the latitude of regulatory agencies such as the FPC is restricted by "the ambit of

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[8] For pending legislative proposals affecting producer regulation under the Natural Gas Act, see e.g., S. 371, S. 1162, S. 1549, S. 2048, S. 2506, S. 2806, H.R. 480, H.R. 2533, H.R. 2866, H.R. 3299, H.R. 3566 H.R. 3685, and H.R. 7507, all 93rd Congress, 1st Session.

[its] . . . statutory authority" (FPC Pet., p. 7a)[9] and that Section 16 does not give the Commission independent powers (FPC Pet., p. 10a). In short, there is no authority within the four corners of the pertinent provisions of the Natural Gas Act which justifies or validates the shift of rate regulatory responsibility as proposed by the Commission.

B. Prior Interpretations By The Commission And The Courts Do Not Support The Commission's Action.

It is of significance to note that, in the early days of producer regulation, the Commission's own interpretation of its powers under the Natural Gas Act fully comports with the decision of the court below.

Shortly after the *Phillips* decision, and before the institution of area rate proceedings, the Commission acted to simplify the filings by small producers, relying upon its authority to prescribe different procedures for different classes of regulated companies under Section 16 of the Act. Nevertheless, in so doing, the Commission recognized that the coverage of the Act was *mandatory,* and it stated in Order No. 174-B, 13 FPC 1576, 1577 (1954):

> "5. Some of the petitions urged that the regulations be amended to relieve small producers from the requirements of the statute. *The Act does not provide for exemptions from its requirements,* but

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[9] *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 586 (1942); see also *FPC* v. *Louisiana Power & Light Co.,* 406 U.S. 621, 642 (1972):

> "FPC and other agencies created to protect the public interest must be free, '*within the ambit of their statutory authority,* to make the pragmatic adjustments which may be called for by particular circumstances' [citing *Natural Gas Pipeline*]." (Emphasis supplied.)

the regulations for producers are herein revised in Sections 154.91, 154.92, 154.94 and 157.23 to further simplify the filings by small producers." (Emphasis supplied.)

Judicial recognition to the same effect is *Saturn Oil and Gas Company* v. *FPC,* 250 F.2d 61 (10th Cir. 1957), *cert. denied,* 355 U.S. 956 (1958), wherein the Tenth Circuit stated:

> "*There is nothing in the Natural Gas Act which makes its applicability depend on the size* or the integration *of the gas operator.* The Phillips decision holds that the Act applies to *all* wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations." (Emphasis supplied.) 250 F.2d at 66-67.

Thus, the past history of producer regulation fully confirms and underscores the correctness of the decision of the court below that the regulation of *all* jurisdictional rates is mandatory, and that classification power under Section 16 does not provide authority for the Commission's actions herein.

In its Notice of Proposed Rulemaking, in Order No. 428, and in its arguments to the court below, the Commission has attempted to construe this Court's decisions in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) and *FPC* v. *Hunt,* 376 U.S. 515 (1964) as supportive of its attempt to shift rate responsibility from small producers to pipelines. Although counsel for the Commission appear to have abandoned their reliance on *Hunt* in their arguments to this Court, it is clear that these decisions do not support the Commission's action.

In its first area rate proceeding, the Commission provided for special treatment for small producers by exempting them from certain filing requirements under Sections 4 and 7 of the Act. 34 F.P.C. 159, 234, 235 (1965). On review, this Court held in *Permian* that the Commission's separate classification of small producers pursuant to Section 16 powers was consistent with its statutory responsibilities. 390 U.S. at 787. However, as the Court of Appeals noted, the small producers in *Permian* were expressly limited to the "just and reasonable" area rate determined by the Commission under Sections 4 and 5 of the Act. The court below said:

> ". . . the Commission is saying that the whole issue in the lawsuit is no different from *Permian*. That just isn't so. The absence of such a 'just and reasonable' limit *is* the big difference. Order No. 428 not only allows small producers to exceed the reasonable and just area rate ceilings—it allows them to do so on the basis of the free market, which is the antithesis of regulation." (Emphasis in original.) (FPC Pet., p. 11a, fn. 18).

The Commission also cites *Permian* in its brief to this Court for a number of general propositions; for example, it said that the FPC is "not bound to the service of any single regulatory formula" (FPC Brief, p. 21); that the Commission's broad responsibilities "demand a generous construction of its statutory authority" (FPC Brief, p. 23); and that the Commission's efforts here are entitled to a "presumption of validity" *(ibid)*. In the context of the *Permian* decision, however, none of these general propositions can be interpreted as supporting Commission action in the instant case which goes far beyond "the ambit of its statutory authority."

Likewise, the Commission's earlier reliance on *dicta* in *Hunt* suggesting that the Commission study NLRB exemption procedures was shown by the Court of Appeals to be inapposite; simply put, the Natural Gas Act, unlike the National Labor Relations Act,[10] does not give the FPC discretion to decline to exercise its jurisdiction over the seller of natural gas by purporting to regulate producer rates at the pipeline-purchaser level.

C. The Commission's Novel Theory Of So-Called "Indirect" Regulation Is Unfair And Unjust To The Pipelines.

The Commission now appears to concede that it has no power to provide an outright exemption from rate regulation to small producers, by stating that it has not asserted any such authority (FPC Brief, p. 18). In what can only be viewed as an attempt to both camouflage and justify its action, the Commission has turned to the illusory device of "indirect" regulation. But as we have shown, there is no authority whatsoever under the Natural Gas Act for such a novel regulatory approach which, we submit, is unfair and unjust to the pipelines.

The Commission attempts to justify its so-called "indirect" regulation by resort to the fiction that the rates of small producers will continue to meet the statutory "just and reasonable" standard (FPC Brief, p. 13), but this claim would appear to be self-contradictory. As hereinabove noted, the theory of indirect regulation shifts the burden of rate responsibility to the pipeline purchaser. If the rates of the small producer were, indeed, "just and reasonable," then there should be no problem with respect to the pipeline's ability to re-

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[10] 29 U.S.C. 160(a).

cover payments made to small producers as a part of the pipeline's cost of service. Yet, this is precisely the issue that concerns the pipelines in this proceeding, namely, that, at a later date, the Commission may determine that the price is in excess of what the Commission, at that time, determined to be a "just and reasonable" rate and that the pipeline would be required to refund such excesses to its customers.

1. Contrary to the Commission's Assertion, Its "Indirect" Approach to Rate Regulation Was Reviewed by the Court Below.

The Commission would have this Court believe that the lawfulness of the "indirect" regulatory method was not reached by the court below (FPC Brief, p. 20). A fair reading of the court's decision, however, leads to the inescapable conclusion that the court examined the *entire* scheme, of which the "indirect" method of regulation was an integral and essential feature, prior to determining that the plan did not satisfy the statutory mandate. In specifically referring to the Commission's "indirect" method of reviewing producer prices, the court below stated:

> ". . . Nothing at all insures that those levels will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a, 13a).

Again, with respect to the concept of "indirect" regulation, the court below forcefully pointed out that regulation and nonregulation are essentially different concepts, and that:

> "It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards. Since the Commission itself has not been confident enough to conclude that the market will necessarily yield rates that comply with the statute, this court can hardly uphold the Orders on that ground." (FPC Pet., p. 14a).

Finally, reference to Judge Fahy's dissenting opinion likewise clearly demonstrates that the "indirect" method of regulation was indeed reviewed by the court below. Although Judge Fahy would have approved the Commission's proposal on an experimental basis, he nevertheless recognized that, under the Act, the Commission should be in a position to protect pipelines and large producers "in the event the Commission finds they have been charged unreasonably high prices by small producers" (FPC Pet., p. 22a). He, therefore, would modify Order No. 428 by striking the provisions prohibiting refunds by small producers to the pipelines and large producers *(ibid).*

As the above discussion shows, the Commission's characterization of this aspect of Order Nos. 428 and 428-B as undecided by the court below is as unfounded as its assertion that small producers' rates are not deregulated by operation of those orders.

2. The Commission's Plan Does Not Regulate the Rates of Small Producers.

As demonstrated hereinabove, Congress has mandated—and the courts have so interpreted—that the Commission shall regulate *all* wholesale sales of gas interstate commerce regardless of the size or classification of the seller. In that connection, Congress clearly intended that the burden of rate regulation should fall directly on the seller, not the buyer. In point of fact, the Commission's "indirect" scheme imposes *no rate burden whatsoever on small producers.*

No amount of strained semantics can conceal the plain fact that small producers have, indeed, been relieved of the statutory "just and reasonable" standard with respect to their rates. There should be no confusion in the Court's mind on this critical point. As Order No. 428 makes clear, a small producer is free to collect whatever contract rate he is able to demand, through negotiation, from a pipeline or large producer purchaser, and the Commission seeks to assure the small producer that the provisions of its contracts will not be subject to change (App. 137; see also, *App.* 249). Furthermore, the small producer would have no obligation to refund any part of the contract price received during the interim period, even if the Commission were to later determine in a pipeline rate proceeding that the contract price exceeded the "just and reasonable" rate (App. 142). By way of example, therefore, a small producer may *receive and keep* his contract price of, say, 60 cents per Mcf even though the Commission were later to determine that a level in excess of 35 cents for that particular transaction was "unreasonably high." Quite clearly, the small producer is free to retain the portion thereof determined

to be "unjust and unreasonable," and the Commission nowhere claims otherwise. The lower court fully comprehended the import of this scheme,[11] and determined that it amounted to *non*regulation in derogation of the mandatory terms of the statute (FPC Pet., pp. 12a, 13a).

Recognizing the obvious infirmities of its position, the FPC belatedly announced that it would retain Section 5 powers to order a *prospective* reduction in small producer rates, thereby limiting what had previously been announced as a total exemption, with concomitant "certainty" of contract prices. But, we submit, this eleventh-hour pronouncement is self-defeating. This *post hoc* effort to instill in its orders a semblance of continuing regulation, which is seen for the first time in the Commission's petition for rehearing to the court below, is wholly at odds with the previously stated ironclad assurance that small producers' contract prices would *not* be subject to reduction and refund. To add, at this late time, the possibility of a reduction in the rates of small producers pursuant to Section 5(a) of the Act only compounds the regulatory uncertainty and risk and will be, therefore, counterproductive to the Commission's entire rationale underly-

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[11] The court below took note of the change in the title of Order No. 428 to "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed Filing Requirements" from the broader and more forthright title of its Notice of Proposed Rulemaking, "Exemption of Small Producers from Regulation." As the court pointed out (FPC Pet., p. 5a), however, the actual terms of Order No. 428 "belie its title's suggestion that its effect is more limited than that implied by the broad title of the Notice of Proposed Rulemaking." Insofar as its effect on small producers was concerned, the substantive provisions remained unchanged from Notice of Rulemaking to the actual issuance of the rule.

ing the instant rulemaking. Remarkable also is the fact that the Commission, having announced that it intended to retain Section 5 (a) powers, still declined to indicate that it would in fact employ such powers to reduce small producers' rates, prospectively, even when it determines such rates to be in excess of the "just and reasonable" rates (FPC Brief, pp. 15, 31 n. 16). Apparently, the Commission believes that the mere retention of Section 5(a) powers is somehow sufficient, in and of itself, to validate its actions herein.

Even if the Commission were to exercise its Section 5(a) provisions by reducing, prospectively, a small producer's rates, it would not cure the illegal financial burden placed upon the pipeline and large producers for the period commencing with the date of initial delivery until the date, after hearing, upon which the Commission's order reducing the small producer's rate becomes final.[12]

3. The Commission's Imposition of a New Regulatory Burden on the Pipelines Is Patently Unreasonable and Unfair.

The Commission argues that its proposal to shift the cost responsibility for small producers' rates to pipelines (and large producers) represents nothing new or unfamiliar under the Natural Gas Act, since "the pipelines' rate base has always been limited to reasonable costs" (FPC Brief, p. 33). As applied to pipelines'

[12] In this connection, it should be noted that the Commission had adopted area rate procedures in an effort to shorten the exceedingly lengthy time which had been required to regulate producers on an individual company basis. Individual 5(a) proceedings against small producers would undercut the administrative progress made as a result of the area rate technique, and the lengthy proceedings would simply prolong the pipelines' exposure to the illegal economic burden placed on them by Order Nos. 428 and 428-B.

purchased gas costs, however, this concept has definite limitations, and runs counter to the Commission's own thinking on the effectiveness of indirect review of producers' rates, subsequent to this Court's decision in the *Phillips* case, *supra.*[13]

First, contrary to the impression which the Commission's statement seeks to convey, the Commission's attempt to shift the burden of small producer rate regulation to an "indirect" review of pipelines' justification of the contractually negotiated prices paid to small producers represents a remarkable departure from prior practice. Before the effective date of the Commission's Orders exempting small producers from rate regulation, the affected producers either had rates on file with the Commission or were subject to area rate ceilings prescribed by the Commission. These rates were the only rates which the purchasing pipelines could legally pay for the purchased gas; having paid the filed or fixed rates, these purchased gas expenses could not be questioned in subsequent pipeline proceedings as to the propriety thereof. See generally, *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.,* 341 U.S. 246 (1951), and *Jupiter Corporation* v. *FPC,* 424 F.2d 783, 788 (D.C. Cir. 1969). Thus, the Commission has the responsibility to regulate producer rates *directly;* accordingly, its reliance on the general proposition that pipelines must justify the reasonableness of all expense items is inapposite to the instant situation.

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[13] For the Commission's thinking on this issue prior to *Phillips,* see p. 27, *infra.* It is there shown that this Court rejected the Commission's "indirect" approach to controlling producers' rates.

Second, the Commission's new approach unaccountably ignores its own post-*Phillips* statement bearing on the efficacy of such an "indirect" approach:

> "Control limited to approving the costs of the gas to the purchasing pipelines is, of course, *not an effective way to regulate producer prices because* in the large *a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities.*" [14] (Emphasis supplied.)

Given today's highly competitive market for available gas supplies, it is patently unreasonable for the Commission to hold out the threat of disallowing legitimate purchased gas expense items, which the Commission itself is encouraging the pipelines to incur. By placing the onus of determining what constitutes an "unreasonably high" price upon the pipeline purchasers, without at the same time providing a definitive standard for determining the level or levels of appropriate prices, the Commission is abdicating the responsibility imposed upon it by the Natural Gas Act. Certainly, if the pipelines knew what level or levels would be permissible to pay, there would be neither a complaint by the pipelines nor a reason for deregulation of the small producers. It is only because of the uncertainty of the levels to which such prices will rise (above the previously determined "just and reasonable" levels for the particular producing areas) that the Commission seeks to shift the burden to the pipelines.

In this period of serious natural gas shortage, pipelines are thus placed in an untenable position. As noted

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[14] *Texas Eastern Transmission Corporation, et al.*, 29 FPC 249, 256 (1963), *aff'd sub nom United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

earlier, competition among buyers for the small amount of available gas is very intense. Particularly because the intrastate market is unregulated, the pipelines are under extreme pressure to pay ever-increasing prices for the small amount of gas which is coming to market. Thus, while the basic aim of the pipelines is to acquire additional gas to serve market demands, they are under the constant threat of having their costs disallowed under a vague and unworkable standard.

4. This Court Has Previously Rejected "Indirect" Regulation of Producer Prices.

As far back as 1951, the Commission rendered a decision in which it ruled that Phillips Petroleum Company was not a "natural-gas company" within the meaning of the Natural Gas Act. 10 FPC 246 (1951). In partial justification of its interpretation of the Act, the Commission stated:

> "Likewise, in the exercise of its power to regulate the wholesale rates charged by interstate pipeline companies, this Commission has ample authority to inquire into the reasonableness of all items of operating expense—including the cost of purchased gas—and to disallow, for purposes of rate-making, items of cost which are collusive or otherwise improperly excessive."[15]

Upon subsequent review, this Court, in its landmark *Phillips* decision, flatly rejected the Commission's interpretation of the Act and held:

> ". . . we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by

[15] For the contrary—and better—view, see the *Texas Eastern* decision, quoted at p. 26, *supra*.

a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." (Emphasis supplied and footnote omitted.) 347 U.S. at 682.

In view of the above and the clear language of the Natural Gas Act, it is difficult to comprehend how the Commission now seeks to justify its "indirect" regulatory approach as being "within the ambit of its statutory authority."

As pointed out by the Court of Appeals, the case at bar may present only a part of the problem. The court below was concerned that if what the Commission purported to do in Order No. 428 for small producers were determined to be a reasonable and lawful exercise of its discretion, then the Commission might proceed to provide a similar exemption for "medium" producers (FPC Pet., p. 15a). This concern, no doubt, was heightened by Commission counsel's frank admission at oral argument to the court below that nothing would preclude the Commission from so doing. The court stated:

"... We think it undeniable that the Commission could, under its theory of this case, proceed to establish another class of 'medium' producers, and provide the same or different appropriate exemptions for this new class, and Commission counsel so conceded in oral argument. Likewise, the Commission could, again by its own fiat, change the definition of small producer to include those with greater volumes of jurisdictional sales.

If Order No. 428 is upheld, no limit appears which could halt gradual erosion of the statutory standard's applicability. Given the Commission's self-professed distaste for regulation, a decision upholding its approach here might soon yield further FPC decisions which made the instances where rates were determined by the 'just and rea-

sonable' standard the exception rather than the rule." (FPC Pet., 15a, 16a).

Carried to its logical extreme, the Commission could eventually purport to regulate *all* producers "indirectly" if its small producer scheme is upheld. Such a result would bring us full circle to the situation existing prior to the *Phillips* decision, and cannot, therefore, be countenanced even in its incipient stages.

D. The Commission Has Lawful Options To Reach The Same Objective.

The court below, while clearly sympathetic to the Commission's problems and having itself approved previous experimental attempts to deal therewith,[16] recognized that small producers may indeed be entitled to higher "just and reasonable" prices than large producers, given their special problems and practices (FPC Pet., p. 162). Such a determination, the court below concluded, is certainly conceivable within the letter and spirit of the Natural Gas Act *(ibid)*. Such a determination could be based upon supporting record evidence. The pipelines (and the larger producers) would be released from the economic squeeze under Order Nos. 428 and 428-B, since they would then be entitled to recoup the "just and reasonable" prices paid to small producers.

The pipelines are in favor of providing stimuli to producers of all classes and sizes to encourage the finding of gas. Such stimuli, however, should be provided directly, either through lawful administrative action or through new legislation if required; and the pipelines must be protected from loss for the prices they are required to pay for gas if their financial stability is

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[16] See, e.g., *Public Service Commission of New York* v. *FPC*, 467 F.2d 361 (D.C. Cir. 1972).

to be maintained. It will do the public no good to have more gas available in the producing fields and have no viable means of transporting the gas to the consumers. As this Court recently held in *FPC* v. *Memphis Light Gas & Water Division,* —— U.S. ——, 93 S.Ct. 1723, 1732 (1973).

> ". . . Under *Hope Natural Gas* rates are 'just and reasonable' only if the consumers' interests are protected and if the financial health of the pipeline in our economic system remains strong."

CONCLUSION

For all of the reasons set forth hereinabove, INGAA urges this Court to affirm the court below's judgment setting aside Commission Order Nos. 428 and 428-B.

Respectfully submitted,

Christopher T. Boland
Gallagher, Connor and Boland
821 Fifteenth Street, N.W.
Washington, D.C. 20005
Attorney for Interstate Natural Gas Association of America

Of Counsel:

Jerome J. McGrath
Vice President and
General Counsel
Interstate Natural Gas
Association of America
1660 L Street, N.W.
Washington, D.C. 20036

Robert G. Hardy
Gallagher, Connor and Boland
821 Fifteenth Street, N.W.
Washington, D.C. 20005

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